IN THE

Supreme Court of the United States

October Term, 1962

No. 78

CHESTER A. PEARLMAN, Trustee,

Petitioner,

vs.

RELIANCE INSURANCE COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF AMICUS CURIAE EDWARD M. MURPHY IN SUPPORT OF PETITIONER

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TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

THE INTEREST OF THE AMICUS CURIAE

Your amicus curiae is attorney for Paulus F. McKee, Trustee in Bankruptcy for Funderburk Construction Corporation, a road construction contractor. Funderburk Construction Corporation was adjudicated a bankrupt in Case No. B-47910 in the United States District Court for Oregon. At the time of the bankruptcy the bankrupt had

partially completed the construction of a United States' forest access road known as the "Yellowstone Creek Project". The Trustee employed a contractor to complete the contract at a cost of $38,971.35 and thereby became entitled to receive from the Government a total payment of $59,702.66 or a net benefit to the bankrupt estate of $20,731.31. Federal Insurance Company, a Miller Act surety, paid laborers and materialmen on the Yellowstone Creek Project a sum in excess of $31,000.00 and has asserted a claim before the Referee in Bankruptcy to all of the proceeds due the Trustee from the completion of this project. A hearing has been held on this claim but the Referee has withheld decision pending the outcome of this case.

There is also now pending in the Court of Claims an action entitled "Phoenix Insurance Company, a corporation, and Stoen-Anderson Contractors, Inc., Plaintiffs vs. The United States of America, Defendant, Paulus F. McKee, Third Party Defendant, Case No. 120-60". In this case the plaintiff was a Miller Act surety on a bond for the construction by Funderburk Construction Corporation of a United States Government road in the State of Washington. The surety paid to certain subcontractors the sum of $53,437.38 and is asserting a claim to the retainage of $50,632.39 now held by the United States Government. The contract was completed prior to bankruptcy. The taking of testimony in this case has not been completed. On October 8, 1962, this Court granted permission for the filing of this brief.

ARGUMENT

THE SURETY-RESPONDENT IS NOT ENTITLED TO AN "EQUITABLE PRIORITY" IN THE ASSETS OF THE BANKRUPT

We believe that the Court's attention in this case should be focused entirely on the Bankruptcy Act. The case merited certiorari because it involved an important issue under the Bankruptcy Act. In Phoenix Indemnity Company v. Earle, 218 F.2d 645 (C.C.A.9) the Court placed particular emphasis on the fact that the issue here presented must be considered within the framework of the Bankruptcy Act. The surety here is seeking a priority in the funds of the bankrupt and the narrow issue before the Court is whether he is entitled to such priority under the Bankruptcy Act. Judge Medina at page 658 stated the issue to be "whether laborers and materialmen have an equitable priority in the retained funds". It is to this issue of "equitable priority" under the Bankruptcy Act that we address this brief.

The theme of the Bankruptcy Act is "equality of distribution". Nathanson v. N.L.R.B., 344 U.S. 25,29, 73 S. Ct. 80 (1952); U.S. v. Embassy Restaurant, Inc., 359 U.S. 29,31, 79 S. Ct. 554 (1959). If a preference is to be given a creditor the purpose should be clear from the statute. Nathanson v. N.L.R.B., 344 U.S. 25,29, 73 S. Ct. 80 (1952).

We assume that the term "equitable priority"

presupposes a security interest cognizable in equity. Justice Holmes in Sexton v. Kessler & Co., 225 U.S. 90, 52 S. Ct. 657,659 (1912) considered equitable lien as synonomous with equitable priority.

In U.S. v. Munsey Trust Co., 332 U.S. 234,243, 67 S. Ct. 1599,1603 (1947) the Court rejected the surety's claim to a security interest stating:

> "In any event, we are not prepared to apply law relating to security to unappropriated sums which exist only as a claim".

And this language has been subsequently relied on in rejecting the claim of a surety to an "equitable priority"; Fidelity & Deposit Co. v. New York City Housing Authority, 140 Fed. Supp. 298; and considered the heart of the Munsey Case by a law review commentator; see 33 Cornell Law Quarterly, 443,445.

An equitable lien presupposes a res to which a lien could attach but here the withheld payments never existed as a separate fund but were at all times a part of the general assets of the United States against which a voucher might be drawn by the contractor.

McKey v. Paradise, 299 U.S. 117, 575 S. Ct. 124 (1936)
Dillon v. Barnard, 21 Wall 430 (1874)
Sexton v. Kessler & Co., 225 U.S. 90, 52 S. Ct. 657 (1912)

If there could be said to be a res there is no evidence of any act by the United States

Government setting the res beyond its control and charging it with the claims of laborers and materialmen. In McKey v. Paradise, 299 U.S. 117, 575 S. Ct. 124 (1936) an attempt was made by representatives of an employees' welfare association to establish on behalf of the employees an "equitable priority" for wage deductions made by a bankrupt employer. The Court denied that the employees had "equitable title" or lien upon any part of the employer's property, stating: (P. 122)

> "No fund was segregated or set up by special depositor in any manner. When the wages became due, there was no such fund but only the general assets of the employer and its obligation to pay a debt."

We believe none of the elements of any "equitable priority" or lien are present in this case. There was no agreement to create a lien; there was no res to which a lien could attach and finally there was no appropriation of the res for the benefit of the laborer and materialmen.

Of course the laborers and materialmen had reason to expect that the contract proceeds would be applied to the payment of their claims but as stated in Dillon v. Barnard, 21 Wall 430,440 (1874),

> "The case * * is * * one of simple disappointed expectations against which misfortune equity furnishes no relief."

Since the term "equitable lien" is an "elastic phrase" (Collier on Bankruptcy, 14th ed Sec.

60.37 p. 884) and "intensely undefined" (Brunsdon v. Allard, 2 El. & El. 19) the proper administration of the Bankruptcy Act requires that it be confined within traditional narrow limits otherwise the "theme" of the Bankruptcy Act "equality of distribution" will be frustrated.

CONCLUSION

It is respectfully submitted that this Court should reverse the decision of the Second Circuit in the United States District Court for the Western District of New York and affirm the decision of Referee in Bankruptcy James R. Privitera. This would preserve the symmetry of the Bankruptcy Act and it would afford equality of distribution to all of the creditors.

Respectfully submitted,

Edward M. Murphy

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Amicus Curiae

I hereby certify that I have served a copy of the foregoing brief on Hon. Raymond T. Miles, 942 Ellicott Square Building, Buffalo 3, New York, Petitioner's counsel of record, and Hon. Mark N. Turner, 440 M & T Building, Main and Swan Streets, Buffalo 2, New York, Respondent's counsel of record, by depositing, on October 17, 1962, a copy of same in a United States mail box with airmail postage prepaid, addressed to each of the above-named counsel

of record at the post office address set forth above.

Edward M. Murphy
Amicus Curiae